RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

Since 1958

Post Office Box 1759, La Jolla, California 92038

26 Letters Per Year • $250 annually

Aug. 27, 1997 **LETTER 1233**

THE MARKET: It's a bull market until proved otherwise. Well, it is, isn't it? But why guess, let's ask the market to prove itself (as we have so many times before).

How do we do that? Simple, we'll just watch to see whether the D-J Industrial Average and its companion, the D-J Transportation Average, can rally to new highs. If on any forthcoming rally, both Averages advance to new highs, then the bull market will be reconfirmed and the green light will be flashing again. If one or both Averages fail to advance to new highs, then we'll be on our guard. But let's not jump the gun. Let's just watch and let the stock market tell its own story, in its own good time.

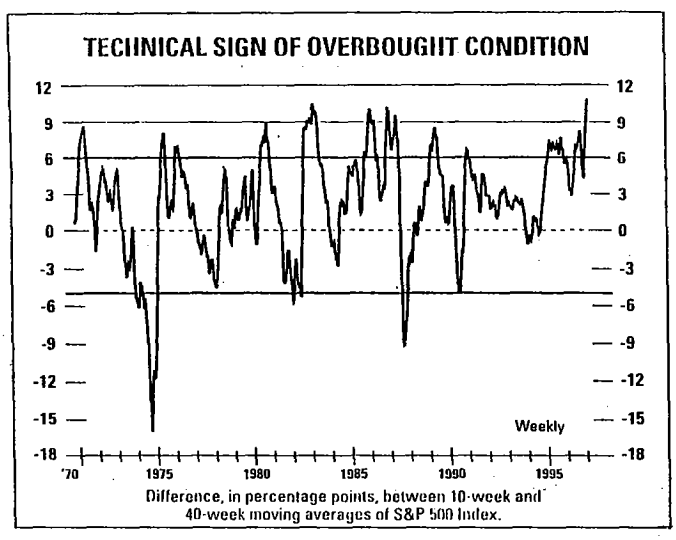
Here are the highs that we'll be watching. First, there's the August 6 record Dow high of **8259.31.** Then we have the August 6 D-J Transportation record high of **3009.25.** And finally there's the S&P 500 record August 6 close of **960.32.** If the bull market is still alive and healthy, all three of these averages should, in due time, rally to new record highs.

STUDIES: Dozens of technical studies exist, all of them seeking to tell us whether the market is over-bought or over-sold or somewhere in between.

Many of these studies work on what I call the "rubber band" principle. Let me explain: markets tend to move in trends. But when a stock average pushes too far above or below a given trend, the reaction is much like a stretched rubber band. What happens is the rubber band tends to pull the average back towards its long-term trend.

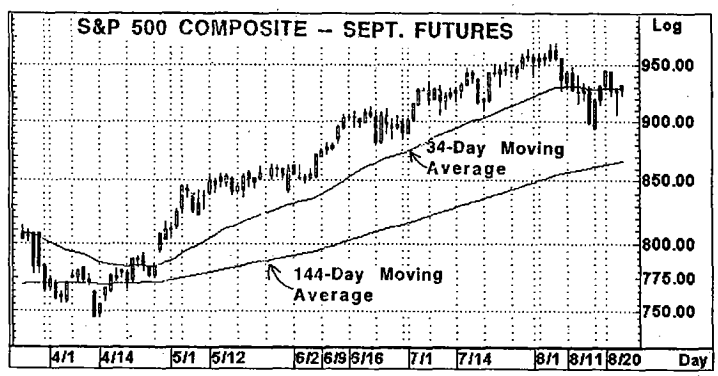
Strain: Standard & Poor's *The Outlook* recently published this chart. Referring to the S&P 500, the chart shows the difference between a 10-week exponential moving average and a 40-week exponential moving average.

The chart is significant, and this is why -- the differential of the two moving averages a few weeks ago rose to **plus 11%.** This represents the **largest differential** since the study was first started 27 years ago.



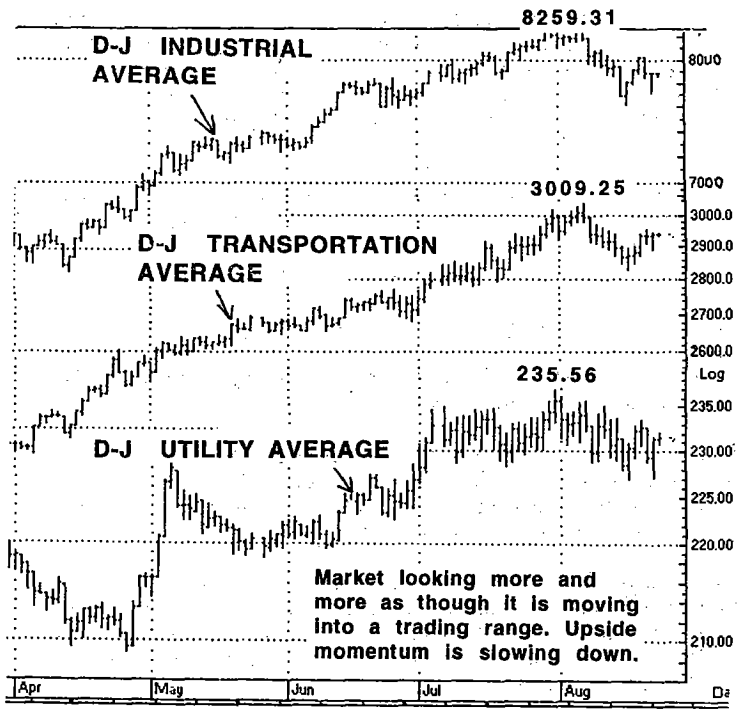
Aug. 15 DJIA 7694.66; PTI 5008; A-D Ratio +8.22
Aug. 22 DJIA 7887.91; PTI 5022; A-D Ratio +8.29
Dow Yield: 1.66%; Dow Price/Earnings: 21.1
Dow 144-day MA: 7385; Dow 34-day MA: 7940
Dow Times Book Value: 5.57; PTI 89-day MA: 4928
Percentage of Undervalued Blue-chips: 4%
Gold 144-day MA: 348

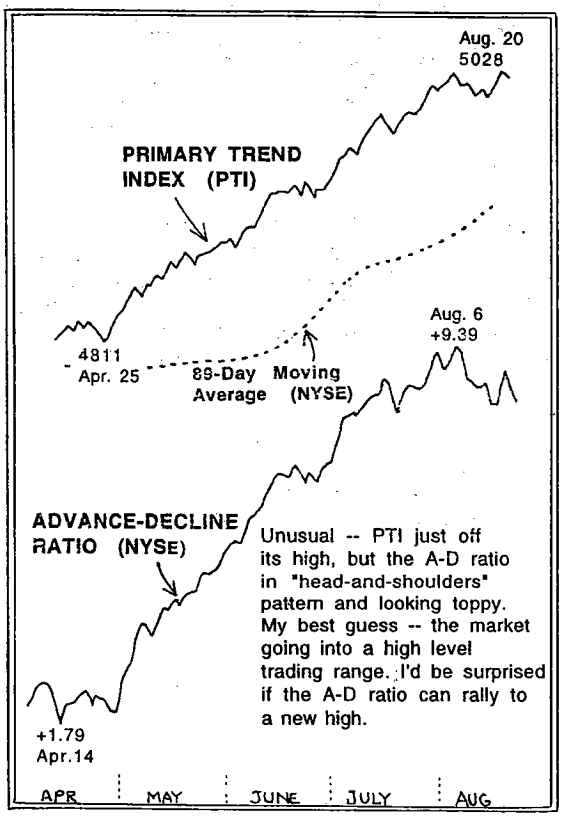
Given that huge differential, what is it telling us? The chart is telling us that there's growing pressure on the S&P to **move back towards the zero line of equilibrium.** In short, the differential rubber band is now stretched very tight.



The next chart shows the September S&P futures. As discussed in many previous Letters, the S&Ps now "run" the stock market. And this is the chart the traders trade off of. Here we see the S&P literally sitting on its 34-day moving average but holding well above its 144-day MA (the 144-day MA stands at 849, and this is a critical level -- see page 3 for detailed interpretation ot the two moving averages).

Next, turn to the page 2 chart of my **Primary Trend Index (PTI).** On August 13, the PTI broke below its steep rising





trendline, a trendline that has been in force since late-April. A minor decline followed, but by August 20 the PTI had climbed to **a new record high. Conclusion:** The PTI had every opportunity to break down over the past two weeks. It didn't do it. As has happened time and time again, the PTI has said, "No," to the downside. On August 20 the PTI surged to a **new record high.**

International: I've always maintained that the US market is the dog that wags the tails of the rest of the world markets. For instance, on the big August 15 market break of 247 Dow points, Brazil's market dropped 4.8%, London's FTSE 100 was down 2.3%, Germany's DAX fell 1.9% and almost all of the world's markets were down substantially.

Yields: A few comments I want to make regarding dividend yields. New-comers and new-era advocates insist that low dividend yields, such as the current 1.6% yield on the Dow and S&P, are perfectly all right, particularly within the context of the new world of continuing prosperity and never a serious stock market correction.

Minuscule or even non-existent dividends may suffice in a bull market, but they won't work in a bear market. In a primary bear market there's nothing like a fat, well-covered dividend to hold a stock up -- or at least resist downside momentum.

With current dividends of $129.84 and earnings of $373.16, the current Dow dividend **payout** is a low 34.8%. Even if dividends were to rise to $186, bringing the payout to a more normal 50%, the dividend yield on the Dow would be only a low 2.5%.

But remember, dividends aren't increased that rapidly. For instance, one year ago Dow dividends were $126.27 while now they are $129.84, a gain of only 2.8% in 12 months -- and this gain occurred during boom times.

Conclusion: The Dow is now ignoring the time-honored price-to-dividend yield relationship -- instead, it's the Dow price/earnings ratio that is trading off of interest rates. Almost every mainstream analyst now talks about interest rates as the determining factor in the P/E ratio for the Dow.

Could the Dow ever de-couple from bonds and bond interest rates? My feeling is that a de-coupling could occur if or when the nation moved into recession. At that time stocks would sink as they discounted sliding corporate earnings, but bonds could rise as the Fed moved to bring rates down. Of course, today nobody is even thinking in terms of a recession, which is why the Dow/interest rate relationship remains so strong and so imbedded in the minds of today's fund managers.

So the **reality** -- interest rates, not dividend yields, are now the determining factor in moving the market.

INVESTMENT POSITION: The bull remains in the box. In the last Letter I stated that it would take a lot more than I've seen so far before I could turn bearish. The statement still holds.

However, I think the bond market, compared with the stock market, offers the better value. After all, with long bonds yielding 6.50% and the Dow yielding 1.69%, it would take a quadrupling of stock yield to equal bond yields. And that's not going to happen in a hurry.

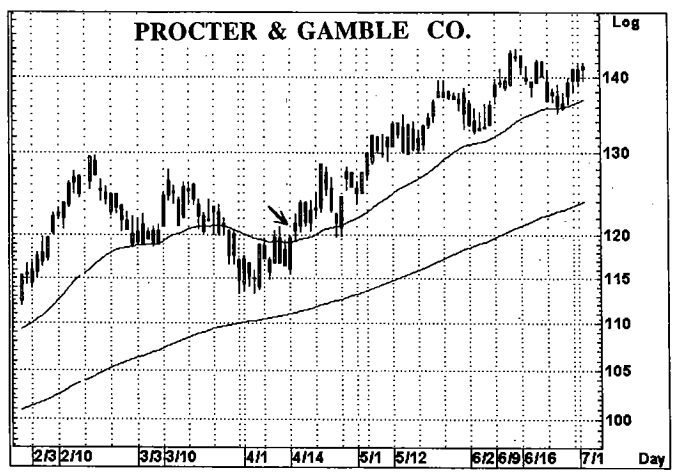
The second reason why I like bonds is that bonds are on a "buy signal" based on my moving average studies. At this point I wouldn't even mind going out 20 years on government bonds.

Inflation/deflation arguments are in the news daily. The **inflation** arguments are based on continuing US prosperity, global pumping up of money supplies, and multiple competitive devaluations in Southeast Asia. The **deflation** arguments are based on global overproduction, vicious world competition, and a decided lack of pricing power. Best barometer of inflation/deflation -- bonds and gold. So far, the picture is neutral, a stand-off.

MOVING AVERAGES: Moving averages are one of the oldest, and at the same time one of the most useful tools in the technician's arsenal. I've used the standard 200-day moving average for decades. However, there's one method that I've found to be extremely helpful and quite reliable, particularly in generating bullish and bearish entry or exit "signals." This method requires two moving averages; I use a **34-day MA** and a **144-day MA.**

Let's examine the bullish entry system. This is based on a decline, but a decline wherein the **34-day MA remains above the 144-day MA.** In this situation, the buy-spot occurs at the point where the price, having declined, then rallies above the 34-day MA.

I illustrate this with this chart of Proctor & Gamble. On April 15 the price, having declined, rallied above the 34-day MA (arrow on chart). This was the buy signal. You can see how well this signal worked out.



The rationale for the system is this: the decline is not powerful enough to drive the 34-day MA below the 144-day MA. Then, when PG rallies above the 34-day MA, that was the signal that says, "The decline was never strong in that the 34-day MA held above the 144-day MA -- so when the price again rallies above the 34-day MA, that's telling us that the weakness was exhausted, and that the basic strength of the market has returned."

The exact reverse is true on the downside which is used to identify weakness and sell-spots (or shorting spots in bear markets). I illustrate this with News Corp. The moving averages were heading down during December to early March with the 34-day MA below the 144-day MA. A rally occurred in March, but the rally was not strong enough to take the 34-day MA above the 144-day MA. When the price broke below the 34-day MA on March 14 (arrow), that was the sell signal.

The stock plunged, hitting a low of 17 1/2 on May 23. From there the stock rallied, but note that again the 34-day MA failed to move above the 144-day MA, a sign of continuing weakness. Then on July 14 the price again plunged below the 34-day MA (second arrow). So NWS continues weak with two sell signals occurring since March.

Important: Of the 30 D-J Industrial stocks, four have dropped BELOW both their 34-day and 144-day MA. These four weak sisters are Kodak, Coke, Merck and Johnson & Johnson. Disney is right on the edge. Almost all the other Dow Industrial stocks are below their 34-day MAs. The critical level for the **Dow** (its 144-day MA) is 7345. Below 7345 -- trouble. The **Bonds** are currently on a buy signal.

NOTES & QUOTES: One of the basic, time-tested tenets of Dow Theory is that **"neither the duration nor the extent of a primary move can be predicted in advance."** For instance, in 1921, with the Dow at 63.90, no one envisioned a bull market that in eight years would carry the Dow to 381.17. In 1929, with the Dow at 381.17, no one, absolutely no one, foresaw a bear market that in 3 years would take the Dow down to 41.22. In 1974 with the Dow at 577.60, no one in his wildest dreams saw the Dow rising to over 8000 in 1997. And here in 1997, no one knows -- well, no one knows.

Prudential's Ralph Acampora expects the Dow to reach 8,750 by year-end—and to rise to 10,000 by next summer. *Encouraging:* Low inflation and interest rates...positive corporate earnings...and a steady flow of new

His favorite

The Very Prudent Sheldon Jacobs Predicts 21,200 Dow by 2010

But they never learn and human psychology doesn't change. Now, with the bull market 23 years old and with stock valuation stretched to never-before-seen heights, the fearless predictions continue to appear. They may be right; they may be wrong; they really don't know, and neither do you or I. But hey, there's no law against predictions, even well-meaning predictions. What's your prediction?

* *

Chancellor Helmut Kohl has staked his political future on the **Euro**, Europe's planned single currency. And he's having a hard time of it. The reason, the German system of high wages and fat benefits, long vacations, and love of the D-mark. A huge defeat for Kohl occurred when he attempted to revise the German tax system. His tax plan was voted down. Kohl and Germany are a key in the battle for the Euro. The real story -- Europe's politicians want the Euro, but Europe's citizens and voters don't want it. In a speech earlier this year, President Roman Herzog asked, "What do I see in Germany? A vast sense of discouragement . . . a crippled feeling hangs over the country. The loss of economic dynamism, the rigidity of life here, an unbelievable mental depression. . . Our problem is a mental one. It isn't as if we didn't know we have to urgently modernize our economy and society. I say we don't have a problem recognizing the situation, but a problem doing something about it."

* *

I got a call from presidential candidate Steve **Forbes** thanking me for my recent enthusiasm for him, his ideas and his campaign. The more I see and hear of Steve Forbes, the better I like him. He is starting a new campaign with ads stating, "We can take our government back from the politicians and bureaucrats who've corrupted it." Forbes has also started AHGO or "Americans for Hope, Growth and Opportunity." If you want to join, and I urge that you do so, send $25 bucks or more if possible to AHGO, 1400 Route 206 N., PO Box 38, Bedminster, NJ 07921.

The corruption, dishonesty and cynicism coming out of Washington is now the most flagrant I have ever seen. We have an impossible tax system, a scandalous president, a corrupt method of raising money, an impossible Attorney General who seems to be working for the President -- and two parties, both of which seem aimless and leaderless. (Is the President a Democrat, a Republican or just a plain opportunist? I think he's the latter.) Did you know that 25% of the Congressmen who departed in 1994 are now lobbyists? What we need now is an honest President who will do what's right for the nation. I'm voting for Steve Forbes. And God save us from Al Gore.

* *

Harry Browne, Libertarian Presidential candidate, in a Letter to the editors of *National Review,* writes as follows: "We should never forget the simple truth, *government doesn't work.* It doesn't matter whether a new program is supposed to achieve something you want or something you don't want. Government doesn't work, and no new programs will work better than the failed programs of the past. It's the same government, the same politicians, the same attempt to achieve social ends by forcing people to do what they don't want to. Not everything in the free market works, but most things that survive do work -- while everything government touches turns out badly. So if you're opposed to poverty, cloning, drugs, abortion, or anything else, you'd better find a free-market way of dealing with it, because government will only disappoint you." **Russell comment:** Too harsh, too anti-government? I don't think so. Why doesn't government work? Because there is **no accountability.** If a private company screws up, if it produces losses or goes bankrupt, then it usually fires those responsible for the screw up. If a government program doesn't work, it asks for more money and more personnel and issues more rules. The government program then becomes entrenched, more inefficient and much more expensive.

* *

By the way, despite all the nonsense and lies you hear out of Washington, it wasn't the Clinton administration that cut the

nation's deficit, it was the higher tax take generated by recent prosperity. And, of course, $60 billion of incoming Social Security money helped to pare down the deficit. Including SS money as income is absurd. Suppose a corporation figured the money coming into their employees' pension plan as corporate income? The corporation's officers would go to jail.

* *

National Debt: Over the last 12 months the US added $193 billion to the national debt, a debt which now stands at **$5.37 trillion.** Interest on the national debt is running to **$235 billion a year.** So even if the budget is eventually balanced (which won't happen under present conditions), the interest on the debt will continue to compound. Then there are future liabilities of the US government, including promises to pay huge obligations for Social Security and Medicare; the total liabilities add up to more than $20 trillion. But not to fret, we'll take care of all that later, much later.

* *

No Inflation: C'mon, even the *NY Times* had to recognize what's really happening. In a front page article (Aug. 13) the *Times* headlined the price pressure that is occurring in many houses and condos. They note that in NYC "cooperative and condominium apartment prices are 12% higher than a year ago, while the city's most exclusive apartments on Fifth Avenue, have soared by more than a third." In the Midwest, median prices of a home are "4.6% above the year before." In California, house prices are firming, and the housing market has become a sellers' market.

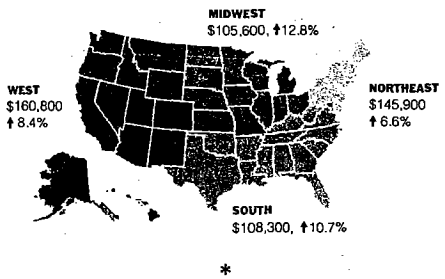
Home Buyers Find the Bidding Wars Are Back

Belmont Heights, Calif. LISTED PRICE: $567,900 — *Lincoln, Neb.* $94,500 — *Dripping Springs, Tex.* $219,000 — *Hackensack, N.J.* $269,900

By CHARLES V. BAGLI

Encouraged by relatively low interest rates and the swelling value of their stock portfolio, Bruce and Alexis Goria plunged into the home buying whirl last spring. They tramped through dozens of houses in Bergen County, N.J., just west of New York City, before finding one they liked.

But the Gorias, a 30-something couple looking for their first home, soon learned that buying a house is not for the weak of heart or pocketbook these days. After losing out



* *

Shocker: *13D Research, Inc.* [(208)726-1565] headlines it, "The Implications of the Global Baby Bust or more coffins than cradles in 79 Countries and 40% of the World Population." What's this? The world population declining? A fertility rate of 2.1 children per woman is needed just to hold a population steady. But look at these statistics: For Italy the fertility rate is 1.2; Spain -- 1.3; Germany -- 1.3; Japan -- 1.5; the Russian Federation -- 1.5. The UN predicts that within 50 years the European population could drop by 90 million. The UN low variant prediction is that African, Asian and Latin American fertility rates are headed towards Europe's rate. In Europe, with many families caring for their elders, and with the burden of social security and pension payments, families are cutting down in the one area where they can cut -- children.

* *

Fed Indicator: Market mavens note that when Fed Chairman Greenspan enters Congress (prior to a speech) if he has a bulging briefcase, it means that he will raise interest rates (the bulging briefcase implies that Greenspan has a big load of data with which to justify a rate boost). Conversely, if Greenspan's briefcase is thin, it means that he intends to leave rates alone. On August 19 Greenspan's briefcase was thin.

* *

GOP? Who's going to be the Republican presidential candidate in '00? Syndicated columnist Robert Novak on a cruise with 500 important Republicans talked about their "yearning for a new Reagan" and their disappointment over the current "leaders," including Newt Gingrich and Jack Kemp. Writes Novak, "That leaves Forbes as the presidential prospect most often mentioned on this luxury ship." **Russell comment:** There's no doubt in my mind that Forbes would be by far the best GOP candidate. I'll be plugging for him from now until 2000.

* *

In a scathing article in the August 8 *WSJ*, George Gilder (editor of the Gilder Technology Report) states that Microsoft may be fighting the wrong war. Writes Gilder, "The fight between Java and Microsoft is a clash of paradigms. Java began with the Internet paradigm and has flourished with the spread of the World Wide Web. Active X, Microsoft's alternative, began on the desktop and is withering on the Net. The winners will recognize that the network is now the computer and the central processing unit is now peripheral. If Microsoft decides to fight this shift to the future by thwarting the necessary moves toward Internet-based computing, it will shrink the industry even if it expands its own power." **Russell comment:** Computing over the Internet. Gad, what will happen to Windows?

* *

Here in computer land they know what the score is. Below are a few interesting letters that were published in the Aug. 13 *LA Times:*

Gates and Apple

■ Ten reasons why Microsoft bought into Apple (Aug. 7):

1. $150 million is lunch money to Bill Gates.
2. Microsoft can't get anyone to take its Internet browser seriously.
3. In two years, the Mac operating system will be called "Windows-M."
4. In four years, the Mac operating system will be called "Windows 2001" and Macs will use Intel CPUs.
5. Microsoft doesn't currently make computers (Apple does).
6. Gates loves surprises.
7. The industry won't let Gates put Windows into digital cable boxes and charge a royalty every time you change the channel.
8. If Apple goes out of business by itself, Microsoft would look bad.
9. Gates can control 99% of desktop computers instead of only 90%.
10. If Apple went out of business, where would Microsoft get ideas from?

P.S. I prefer the Amiga!

GARY DAVIS
Culver City

■ While it is admittedly easy to take aim at the tactics used by Microsoft these days, Richard Kain has presented the facts (Commentary, Aug. 8). As a computer trainer and consultant, it is rare, if not almost impossible, for me to discuss any software package with clients and computer novices other than Microsoft. While Microsoft does indeed make excellent application software, when you own both the application (Word, Access, Excel, etc.) and the operating system (Windows) to run it on, you are not only a monopoly, but the envy of Standard Oil '07, and AT&T '80!

Whatever became of the 1995 consent degree regarding anti-competitive behavior that Microsoft agreed to with the U.S. Justice Department? It is my guess it was written in MS Word.

MICHAEL MASARSKY
Canoga Park

■ The alliance between Microsoft and Apple comes as no surprise to me. Gates can't afford to let his technology engine go broke, or even get stale. The new business arrangement only means he won't have to steal the concepts, there will now be an open pipeline between Cupertino and Redmond.

ROB MUIR
Etiwanda

* *

Forbes ASAP magazine cover story is entitled, "How the West Kicked Butt." The magazine is talking about the western US. A few excerpts: "The East's retreat into Thou-Shalt-Not-ism seems to be picking up speed as the West overtakes it economically. Broadcast TV, the Federal Reserve, stock exchanges based on physical locations, retail giants, these are spent forces in today's burgeoning cyber-economy . . . DRAMS, EPROMs, microprocessors, personal computers, GUIs, PostScript, desktop publishing, desktop video, hubs, bridges, routers, Ethernet, Web browsers, Java, Active X, from all these technologies I count a trillion dollars or two in recently minted market cap. None of it originated from east of the Rockies. Where were you fellas? Hello? Hint: liberate your entrepreneurs, trust your customers, and then get out of the way."

* *

Employment Picture: My 16-year old daughter, Lauren, visited her brother, Ryan, at Berkeley where he is a student. Later the two went to Abercrombie & Fitch to buy a sweater for Ryan. The store manager walked over and offered both kids jobs on the spot. Unfortunately, they couldn't accept. But thanks, Abercrombie.

* *

The medical hierarchy, again. An article in the August 10 *NY Times* magazine section talks of Kilmer McCully and his thesis that homocysteine, an amino acid in the blood, damages artery walls and causes heart attacks in maybe 10% to 15% of all cases. Furthermore, most of the time homocysteine can be lowered to safe levels with the help of common, cheap vitamins. But there's **no money in cheap vitamins** compared with very expensive cholesterol-lowering drugs. The medical profession and the drug companies have resisted McCully's thesis for years. Furthermore, McCully lost tenure at Harvard. Then the Arteriosclerosis Center at MIT attacked his research as "errant nonsense." When McCully went on a Canadian radio broadcast he received a call from the public affairs director of MIT -- "He told me to shut up. He said he didn't want the names of Harvard and Mass. General associated with my theories." Said Thomas James, a cardiologist and president of the Univ. of Texas Medical Branch, "It was worse than that -- you couldn't get ideas funded that went in other directions than cholesterol. You were intentionally discouraged from pursuing alternative questions. I've never dealt with a subject that elicited such an immediate hostile response." **Russell comment:** The whole heart disease situation involves billions of dollars spent for research, expensive surgery, and it affects the very solvency of many hospitals. Cheap remedies for heart disease treatment and heart disease prevention run directly against large entrenched interests. Chelation, homocysteine, vitamins, low fat diets -- they all constitute help for heart attack victims and potential victims and a danger to the medical hierarchy. You want to know what's happening in heart treatment? Follow the money.

* *

Drug War: Any serious debate on even limited legalization of drugs (narcotics) is off limits, forbidden. Yet, the economics of the situation has become more and more horrendous. Every week of the year 1,000 new offenders (all drug-related) are jailed, according to the Bureau of Justice statistics. Last year one out of every 163 US residents was locked up, and by the middle of the year the total number of inmates reached 1.6 million, up from 1.1 million in 1990 and 744,000 in 1985. Today, one in every 118 men is under the jurisdiction of state or federal correctional authorities. Incredibly, the US is now building more prisons than schools. The racial implications are also embarrassing. By the end of 1995, 3.5% of all black men were in prison compared with 0.5% of white men. Seven blacks were in jail for every one white. The reason for most black men to be in prison -- drugs, while for white men it was violent crimes. The costs of drug incarceration are huge, the sentences are now longer, and the war against drugs is spinning its wheels. The corruption of police, officials, and politicians connected with drug enforcement is poisoning the nation. The beat of the drug war goes on.

* *

Comparisons are always interesting, and they help to reveal the psychology of the times. Here are a few comparisons: Dow in 1982 was 776.92, last week it was 8062.11, a rise of 938%. Yield on 30-year T-bond in '82 was 13%, it is now 6.7%. Rate on a fixed-rate 30-year mortgage in '82 was 16.1%, it is now 7.5%. Barrel of oil in '82 was $34, it is now $19.69. Trading on the NYSE averaged 50 million shares a day in 1982, it is now 481 million. Price-earnings on GE in '82 was 9, it is now 29. Number of equity mutual funds in '82 was 340, it is now 2,855.

* *

Today, everybody is "into" stats and comparisons, and the movies are a favorite. Here are a few: Batman & Robin cost $175 million plus. Speed 2, Men in Black, Air Force One and Contact all cost $90 mils. Hercules cost $85 mils. Conspiracy and Con Air both cost $80 mils. The profit-winners were Men in Black, Lost World, Air Force One, and My Best Friend's Wedding. Biggest disappointments were Batman & Robin and Hercules. Biggest loser was Speed 2, Cruise Control, with estimated loss to Fox of $65 to $85 million. Big question mark coming up -- the $250 million "Titanic" due out in December.

* *

When you buy a fad or "hot item," it pays to be careful. Remember when there was a frozen yogurt store on every corner. More recently it's been bagels, but buyers of bagel stocks have not done well. Here are some 12-month changes in listed bagel shares: Quality Dining -- down 85%; BAB Holding -- down 65%; Manhattan Bagel -- down 36%; Einstein/Noah's -- down 54%; Big City Bagels -- down 47%. The problems: over-enthusiasm over the business, too much competition, too easy to get into the business, and a generally saturated market.

* *

Timing, Timing: Even insiders can get it wrong. Fearing that Apple was doomed, Steven Jobs, a founder of Apple, sold $22 million shares of Apple stock in June at a price of around 15. Jobs' sale took place two months before his announcement of Apple's new pact with Microsoft. Following the announcement, Apple's stock rose as high as 30. That meant that at the recent high, Jobs could have picked up another $20 million or more. Ah well. . .

* *

More on Apple/Microsoft, this from the London *Financial Times:* "The new alliance represents a big realignment of the computer industry. That business is divided between enemies and allies of Microsoft. Previously, Apple has been in the 'anti-Microsoft' camp, which includes Netscape, the leading Internet software company, Sun Microsystems, the top supplier of computers for networks, and Oracle, the leading supporter of cheap, simple Internet terminals called network computers. Winning Apple away from this group appears to have been one of Microsoft's motives in forging the new alliance. As part of the deal, Microsoft's Internet browser will become the 'default' program for Internet access on Macintosh computers, displacing Netscape's rival product. Whether this realignment of the computer business is peaceful seems doubtful. Microsoft will no doubt wield influence over Apple. That raises the prospect of a conflict with Mr. Ellison (of Oracle), an outspoken critic of Microsoft."

* *

Tobacco: Here's one cynic's description of the tobacco deal. It allows millions of US smokers to kill themselves under the strict supervision of the US government. Ah, but then there's the promised land, Asia. There are 320 million smokers in China alone. And 67% of men over 15 in China smoke. You may not know this but China is the world's leading producer of tobacco, growing four times as much of the leaf as the US, which is the #2 producer. China's anti-smoking movement hardly exists; it's largely the preserve of a few obscure doctors and researchers. Making it even more difficult, tobacco is the Chinese government's largest single source of revenue. Furthermore, with high unemployment, the Chinese government is wary of adding to the upheaval by limiting tobacco production among the country's 10 million tobacco farmers or imposing taxes on the 3 million outlets where cigarettes are sold. Meanwhile, the Chinese are switching from their cheaper harsh-tasting tobacco to the milder imports. **Russell comment:** Tobacco was introduced to the white man by native Indians. The white man's treatment of the Indians was akin to genocide, and I've often wondered whether tobacco isn't the Indian's revenge.

* *

All-star Kevin Garnett of the Minnesota Timberwolves rejected a six-year contract worth $103 million. Why? His agent wants $132 million. "Whom the gods would destroy, they first make mad." And I'm wondering whether professional athletes are in the process of destroying their respective sports. Of course, the owners help.

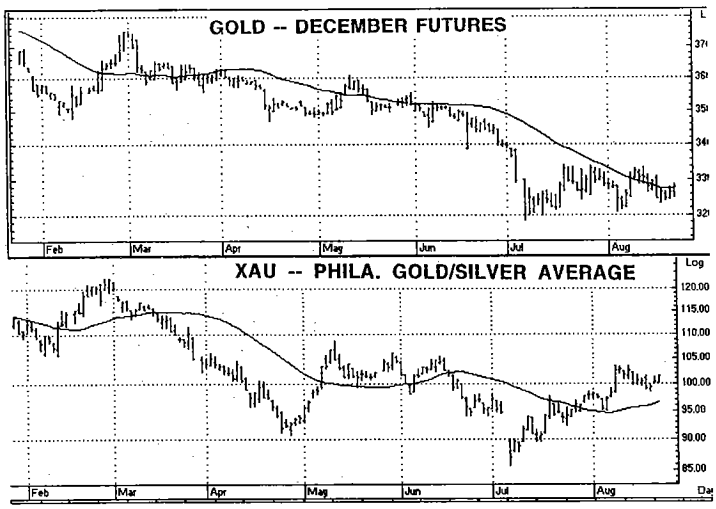
* *

In the new "Air Force One" movie, the US President is in a tense situation aboard a hijacked plane. In the film President Marshall is a tough, two-fisted, fighting hero. The *NY Post* film reviewer notes, "It's fun to think about what would happen if Bill Clinton were in that situation. Sacrificing himself for others hasn't been a hallmark of Clinton's political career. Clinton would talk the hijackers to death, and the movie would be like O. Henry's 'Ransom of Red Chief' where the kidnappers find the hostage so insufferably obnoxious they say, 'Please, take him back.'"

GOLD: Let's ignore all the news and theories regarding gold; let's just assume that everything anybody knows about the yellow metal is contained in the price structure.

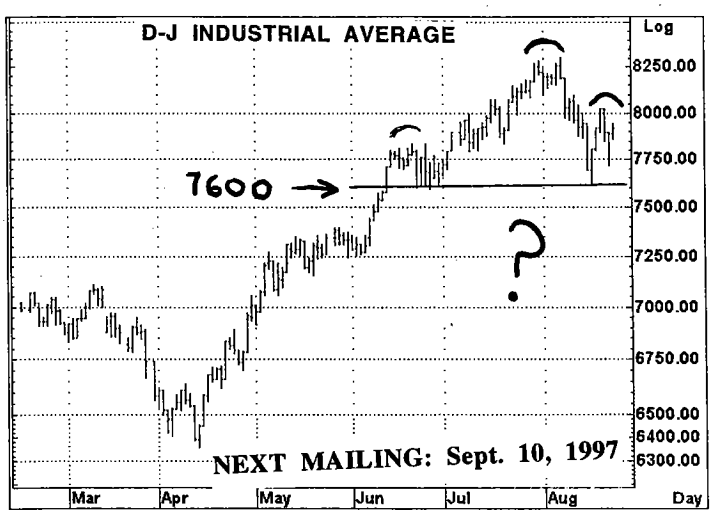
Whatever is happening to gold, it's happening s-l-o-w-l-y. Gold, the metal, appears to be tracing out an extended base. Let me put it another way; as long as the December futures contract (this is the most active contract) holds above the 318 level, I'll consider that the basing process is continuing (see chart). A very positive development would be the December futures rallying to 334 or better.

The precious metal stocks have been acting considerably better than the metal itself. The chart shows XAU (the Phila. Gold/Silver Average) advancing above its 34-day moving average. A decided positive for XAU would be a rise above the 103.54 level, which was the Aug. 13 high.



FAIL-SAFE: Let's try to make it simple. Here's a daily chart of the **Dow**, showing the entire advance since mid-April. A decline during June dropped the Dow to a closing low of 7604.26. Then a new advance carried the Dow to a record high of 8259.31 on August 6. A second decline took the Dow back to an intra-day low of 7616.62.

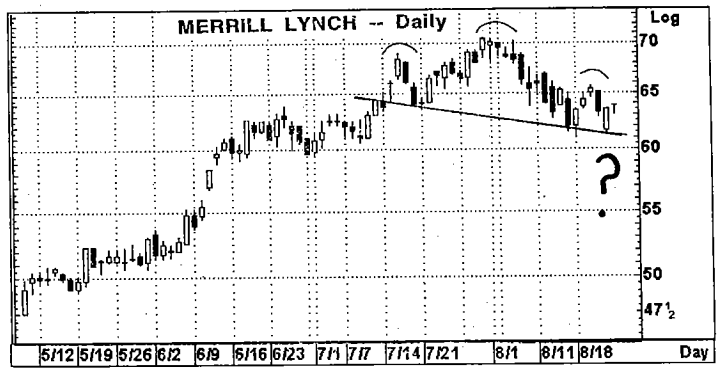
I've drawn a horizontal line at the clear line of support at just above Dow 7600. As long as the Dow holds above 7600 I'm grading the trend of the market as bullish. If, however, prior to advancing to a new record high, the Dow continues weak and breaks **below 7600**, the situation will turn bearish. So it's very important to keep your eye on Dow 7600 -- it's a critical level for the Dow and the market in general.



In a bull market, the odds are always in favor of support levels holding. By the same token, the odds in a bull market always favor prior highs being surpassed. Nevertheless, it's an excellent policy to identify your fail-safe level. **Right now the fail-safe level is Dow 7600.**

BELLWETHERS: If I had to pick one bellwether stock for the market I'd pick Merrill Lynch. History indicates that whether there are good times or bad times coming up for Wall Street, the **brokerage firms will sense those conditions first.** Since Merrill is the largest brokerage firm on Wall Street, this is a stock I always watch.

As this is written MER appears to be carving out a large potential "head-and-shoulders" top. Of course, a potential head-and-shoulders top is just that -- a potential. That is, unless the pattern actually breaks down. The breakdown in MER would come at a closing below the August 18 intra-day low of 61. So keep your eye on MER and the 61 level -- MER under 61 would be a negative for the whole market.



WHY, WHAT? What's bothering the market? Some analysts are saying that the UPS settlement signaled the beginning of a national trend to higher wages, and higher wages inevitably lead to inflation. That would be an easy and logical explanation of why the bonds have been weak.

On the other hand, the dollar looks quite toppy. If you're a foreigner (or a foreign central bank) and you've got profits in T-bonds, if the dollar is heading lower you're going to be very tempted to grab some of those profits, which means you'll be selling US T-bills and bonds. That could explain weakness in bonds, which in turn could explain the weakness in stocks.

Then there's that phenomenon that nobody (unless they are my age) has had any experience with. It's called deflation. I'm not talking about dis-inflation or a lack of inflation, I'm talking about real, honest-to-god DEflation, where the price of goods goes down. Look, already there is almost no pricing power in the wholesale and retail markets, meaning that these guys can't raise prices. But what happens if they have to reduce prices? What happens to earnings then? What happens if consumers get frightened and at the same time prices of everything turn down? Could it happen? In today's world, with every nation producing and wanting to export, yes, it could happen.

But remember, all the above are just thoughts. It's still a bull market until proved otherwise. And we don't have that "otherwise" proof yet.

LATE NOTES: With the yield on the long T-bond at 6.6% and the yield on the Dow at 1.66%, it's clear that buyers have tremendous faith in the future of the stock market and the economy (but they are not making allowances for any surprises).

Sentiment: the bulls are still very confident. The bears are increasingly defensive, but why shouldn't they be, they've been wrong for a long time. My **PTI** couldn't care less about bullish or bearish opinions -- it only cares about **market action**, which is also what we should care about. **Conclusion:** Keep your eye on the PTI.